

Recording of MTC Working Group  
Teleconference  
Sales/Use Tax Constitutional Nexus Guideline  
Task Force II  
July 9, 1997

The teleconference was scheduled to begin at 1:00pm eastern time. After a brief waiting period, roll call was taken by group co-leader Michael Madsen. Present were: Merle Buff, Paul Mines, Richard Pomp, John Towle, David Levine, Dale Bettel, Alan Friedman, Terry Charlton, Martha Mote, Michael Southcombe, Bruce Port, Maggie Mitchell and Cass Vickers.

No comments were received during the public comment period.

Michael Madsen proceeded to introduce the members of the call to the issues assigned to the task force. Although our procedural rules required the presence of both co-leaders to have a quorum, the group decided to proceed with discussion. Shortly after the discussion began, Marilyn Hill's appointed substitute joined the call.

The three issues discussed include:

Working Draft Nexus  
Guideline Reference

Question Discussed

II.A.1	Is the due process nexus standard always satisfied for sales tax purposes by establishing that the sale occurred in the taxing state?
II.B.1	Is the commerce clause nexus standard always satisfied for sales tax purposes by establishing that the sale occurred in the taxing state?
II.C.2. and II.C.3.	Does the indirect ownership of a property interest in the taxing state give rise to "physical presence?"

The first two topics were covered together. Michael Madsen pointed out that, in general, there was some consensus on this matter in Dallas. However, he requested the group to begin by discussing exceptions or clarifications. The following issues were identified:

Topics 1 and 2

Issue

The definition of a "sale" in the document refers to each state statute. However, in general, states define this term as a transfer of title *or* possession. There is an issue in states such as Florida which define each lease payment as a separate sale. Therefore, if a lessor leases property to a lessee which allows (or does not disallow) a lessee to move the leased property into the state, under this standard, the property used in the state by the lessee would create nexus for the lessor for a period of one year; even if the property is located in the state for a shorter time period. (Cass Vickers will submit detailed comments on this issue).

The group discussed the practical issues surrounding notification by the lessee to the lessor as to the property location. In addition, we discussed whether a state would actually pursue constitutional limits on “mobile property” unless the dollars become significant. It was noted that the document would address only whether a state is constitutionally permitted to pursue these items

#### Issue

When does a sale from outside the state occur within a state? Should the UCC definitions of title passage be used, or should the transfer of possession dictate where a sale is made? The Quill case does not address this issue. The location of the “sale” was determined to be outside North Dakota in a lower court decision, so the Supreme Court did not opine as to whether a sales tax collection obligation would be applicable.

We discussed whether the Quill case would have been decided differently if the sale had been deemed to occur in North Dakota. Some comments concluded that, based on other Supreme Court decisions in which a “sale” was deemed to occur within a state (e.g. *Goldberg v. Sweet and Jefferson Lines*), the Quill court would have concluded that the collection requirement would have been different if the sale had occurred within the state.

We discussed that state’s generally define “sale” as the transfer of title or possession. If passage of title is used, we discussed the difficulty in using UCC guidelines. The group discussed whether placing FOB as the vendors location would result in use tax versus sales tax. If title passage is silent, we discussed whether most customers would view title as passing only after possession was transferred in their own state versus the state of origin. It was noted that North Dakota had argued in Quill that the 90 day return policy resulted in title passage in North Dakota. However, the court had not been asked to decide where title passed as the trial court found that title had passed outside North Dakota. A question was raised whether constitutional limits of taxation should turn on whether title passes in a state.

If a standard of transfer of possession is used, then sales tax would always apply to a transaction with a mail order seller unless the purchaser physically picked up the property at the mail order seller’s location.

It was noted that using states definitions of a “sale” could render the decision in Quill meaningless. In walking through several examples regarding mail order sales, it was commented that using this type of definition would *always* result in the item being subject to a state’s sales tax rather than use tax in a typical mail order example. Because the definitions contain the provision that either title or possession transfer constitute a “sale” virtually all mail order transactions have possession being transferred in the state seeking to assert jurisdiction. Therefore, the comment was made that Quill is meaningless under this scenario.

We also discussed the complimentary nature of use tax to sales tax and whether the collection requirement of an out of state vendor (vs. an in-state vendor) should be the same regardless of whether the tax imposed is a sales tax or a use tax. It was noted that two different states could have a claim to make an item a “sale” versus a use. A reference was made to the Goldberg decision that

the Court has recognized that a sale can occur in two places, but that the Court does not find this problematic due to the credit mechanism in place which avoids double taxation.

We discussed how the use of title or possession transfers impacts electronic commerce where items are transferred to the customer "on line". Some comparisons were made to the deregulation of the electric utilities. Additional discussion was deferred to allow time for the third issue.

### Topic 3

We discussed whether indirect ownership of property in a state creates nexus. It was clarified that our discussion should focus on whether attributional nexus is permitted under the constitution. Current practice is that subsidiaries with no physical presence of their own have not been required to file sales tax returns. A question was raised as to whether a parent company's property could create nexus for such a subsidiary.

One point of view is that the National Geographic case stands for a strict legal entity concept and that only activities within a legal entity are subject to the state's jurisdiction. In this view, the constitution does not prohibit corporations to structure themselves in a manner which saves taxes.

Another interpretation of the same case is that the Court recognized that an activity within the state is not required to be related to the business it seeks to tax. The mail order sales of the map division were not exempt from tax collection requirements because the same legal entity operated an unrelated magazine sales office in the state. Therefore, it was commented that it is reasonable to think the Court would allow a parent companies property to be considered in determining whether the subsidiary has nexus.

An issue was raised as to control. Since a subsidiary does not control the activities of a parent, the subsidiary loses the ability to conduct business in a manner similar to a competitor that does not have a parent company. Some found attributional nexus to be a way to level the playing field for in state companies. We discussed whether the attribution principles should follow IRC section 318 where either parent or subsidiary ownership is contemplated (i.e., either one could create nexus for the other).

We discussed whether decisions interpreting Quill or other cases (such as SFA Folio or Bloomingdales By Mail) should be considered as guidance. Some view these as inconclusive because the Supreme Court denied *certiori*.

The group was asked to reflect on the discussion prior to the next conference call which is scheduled for Wednesday, July 16. Our goal for that call is to discuss the areas of consensus. If areas of disagreement exist, the group was asked to be prepared to defend these areas. In addition, if altering the language of the document would allow the group to reach consensus, we should consider and propose language. Some group members requested additional time to pull comments together. This was agreed.